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Alberta Tax Review Committee

Final Report and Recommendations

Future Direction for Personal Income Taxes in Alberta

October 1998

1998 Tax Review Committee

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Alberta Tax Review Committee

Honourable Stockwell Day
Provincial Treasurer

Dear Mr. Day:

On behalf of the Tax Review Committee, we are pleased to submit to you our report and recommendations on issues related to personal income taxes in Alberta. This report completes our Committee's work in reviewing a number of provincial tax issues.

As we stated in the first phase of our work, the Committee believes that the best overall tax policy for Alberta is to provide a low rate, broad based tax environment. That basic position is confirmed in this report and recommendations. We strongly believe that low taxes benefit not only individual Albertans but also strengthen Alberta's competitive position and encourage investment, growth and jobs in the province.

Through our review, we addressed a number of tax policy issues – the need to reduce taxes for low income Albertans, differences in taxes paid by single and double income families, the problem of bracket creep, the impact of high tax rates on Alberta's ability to attract and retain a highly skilled workforce, and the importance of improving Alberta's and Canada's competitive tax position.

Taken together, our recommendations provide a comprehensive response to those issues. The recommendations call for fundamental change to Alberta's personal tax system. While we understand these changes may be controversial for some, we believe that the impact of these recommendations will be greater flexibility, a simpler tax system, lower personal income taxes, a tax break for low income Albertans, more control over the province's tax revenues, and a fairer tax system for Albertans.

On behalf of the Tax Review Committee, we would like to thank you for the opportunity to address these important tax issues. We also would like to thank the many individuals and organizations who made submissions and participated in this review.

We believe these recommendations will lead to a better tax system for Alberta and provide an opportunity for our province to once again take a leadership role in major tax reform in the country.

Jack Donald, Co-Chair

Gary G. Campbell, Q.C., Co-Chair

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Summary

The Alberta Tax Review Committee was established in February 1998 with the task of examining specific aspects of Alberta's tax system, seeking the views of Albertans, and making recommendations to the Provincial Treasurer.

Based on its review of a number of provincial income tax issues, the Committee has prepared recommendations calling for fundamental changes in Alberta's personal income tax system.

Taken together, the Committee's recommendations would provide a tax break for low income Albertans, address differences in taxes for single and double income working families and provide lower personal income taxes for Albertans. The Committee also recommends that the province move to a new system in which personal income taxes are based on how much taxable income people have, rather than how much basic federal tax they pay. This is the most effective way to address taxation issues brought to the Committee's attention. By moving to a new tax on income system with a single rate of taxation and a higher basic exemption level, Alberta would take a leadership position in tax reform across Canada.

The Committee recommends that:

Recommendation 1

The province should reduce personal income taxes within Alberta and continue to encourage the federal government to lower taxes to improve Canada's competitive position.

Recommendation 2

The province should move to a new system of tax on income. The province should not consider separate collection of personal income taxes and a single income tax return should be retained.

Recommendation 3

The province should introduce a single rate of provincial income tax.

Recommendation 4

The Committee recommends a single rate of 11%.

Recommendation 5

The basic provincial personal exemption should be increased and the spousal exemption should be set at the same rate. Both of these exemptions should be fully indexed to inflation.

Recommendation 6

The basic provincial personal exemption and the spousal deduction should both be set at $11,620. Currently, the basic personal exemption is $6,456 and the spousal exemption is $5,380.

Recommendation 7

New tax credits should not be added to Alberta's personal income tax system.

Recommendation 8

The province should urge the federal government to return to full indexing of basic exemptions and tax brackets.

Recommendation 9

The temporary deficit elimination taxes introduced in the late 1980s should be eliminated.

Recommendation 10

The province should continue to review the future challenges to the tax system and assess their unique impact on Alberta.

Taken together, the benefits of this tax reform package include:

- Albertans would pay less in provincial income taxes and would continue to pay the lowest overall taxes in Canada.
- An additional 78,000 low income working Albertans would be taken off the provincial tax rolls and pay no provincial income taxes.
- Differences in provincial income taxes paid by double and single income families would be reduced.
- Marginal tax rates would be reduced in Alberta. Combined with the federal rates, the highest marginal rate in Alberta would be

42.3%, down from the current rate of 45.6%. If the federal government also eliminated its surtaxes, the maximum rate in Alberta would be 40%.

- The tax system would be more progressive. Fewer low income Albertans would pay taxes, and every family type in Alberta would benefit – one and two income families, lone parents, singles and seniors.
- The basic personal exemption would increase by more than inflation for the first time since 1988. And it would more than fully compensate for the lack of indexing since that time.
- A single rate system would be simpler for Albertans to understand.

The Committee believes that this package of recommendations addresses the critical issues brought to our attention throughout the review process. Those issues include:

- The need to lower taxes in order to improve Alberta's and Canada's competitive position.
- The impact of high marginal tax rates and high average taxes on Alberta's economy, including our investment climate and our ability to attract and keep highly skilled and mobile individuals.
- Bracket creep and the impact it has had primarily on low and middle income Albertans.
- The need to give low income working Albertans a tax break.
- Differences in taxes paid by single and double income families.
- The need to eliminate the temporary deficit elimination taxes of the past decade.

The Committee understands that its recommendations will result in fundamental changes to Alberta's personal income tax system. Those changes will provide greater flexibility, simplify the tax system, reduce taxes for Albertans, make the tax system fairer, and provide the province with more control over its provincial tax revenues.

At the same time, the Committee understands that taxes are the price Albertans pay for essential public programs and services. The tax system has to generate the basic revenues needed to maintain those programs to a standard Albertans expect. Any changes or reductions

in personal income taxes have to be sustainable over time. Within that context, the Committee urges the government to consider our recommendations and the benefits these tax changes would bring, both to the province and to individual Albertans.

As members of the Committee, we would like to thank all those who participated in this review. We believe that our recommendations will lead to a better tax system for Alberta, and provide an opportunity for our province to once again take a leadership role in major tax reform in Canada.

Examples of proposed tax savings for Albertans

Provincial personal income tax savings for Albertans
(includes impact of refundable Alberta Family Employment Tax Credit)

	Current ($)	Proposed ($)	Tax Savings ($)
One earner family, two children			
$30,000	601	(239)*	840
$55,000	4,394	3,256	1,138
$100,000	10,761	8,206	2,555
Two earner family, two children			
$30,000	260	(203)*	463
$55,000	3,332	3,161	171
$100,000	8,443	7,968	475
Single senior			
$30,000	1,713	1,639	74
$55,000	5,004	4,389	615
$100,000	11,370	9,339	2,031
Single non-senior			
$30,000	1,803	1,839	(36)
$55,000	4,829	4,534	295
$100,000	11,195	9,484	1,711

* Refund

Share of proposed tax cut

	Percentage of Alberta total income	Percentage of Alberta total personal income tax (under the current system)	Percentage of the proposed tax reduction under the proposed personal income tax system
Under $30,000	29%	16%	34%
$30,000 - $100,000	53%	63%	37%
Over $100,000	18%	21%	29%

Source: Alberta Treasury

Background

Introduction

The Alberta Tax Review Committee was established by Provincial Treasurer Stockwell Day in February 1998 with the task of examining specific aspects of Alberta's tax system and making recommendations to the Provincial Treasurer.

In the first phase, the Committee focused on the importance of knowledge-based industries to future economic development, and the government's role in, and mechanisms for, financing and developing knowledge-based industries and businesses. Issues addressed by the Committee in phase 1 included questions of whether specific tax credits or other mechanisms should be introduced to promote investment in knowledge-based industries, or whether the existing policy of low tax rates for all businesses and industries should be enhanced. A summary of the Committee's recommendations on those issues is included in Appendix 1. Some additional comments and follow-up work by the Committee are included in an afterword to this report.

In the second phase, the focus of the Committee's work was on a number of important issues related to provincial personal income taxes.

What are the key issues?

The Committee examined several matters regarding personal income taxes, including ways to improve Alberta's and Canada's competitive position, addressing the impact of high marginal tax rates, the problem of bracket creep, differences in taxation between single and double income working families, the current tax bracket structure, and the use of tax credits.

The Committee considered each of these in relation to the key question of whether Alberta should move to what is called a "tax on income" approach.

As part of its mandate, the Committee was specifically asked to consider options for Alberta personal income tax, taking into account the following:

- Government's commitment that taxes will not be increased.
- The impact on the economy and marginal tax rates.
- The impact on different demographic and income groups.
- The degree of simplicity and transparency.
- Tax competitiveness.
- Policy implications such as the impact on family and individual taxation, high marginal tax rates, and the trade-off between work and welfare.

The following sections of this report summarize the advice received by the Committee and the Committee's recommendations on Alberta's personal income tax system.

It is important to note at the outset that the Committee's review and recommendations are focused specifically on provincial income taxes. A number of issues raised with the Committee involve tax policies set by the federal government, not the province. Roughly 60% of the personal income taxes Albertans pay are levied by the federal government, not the province. Therefore, while the Committee believes its recommendations will make an important difference to the tax structure Albertans face, there is a limit to what the province can achieve itself. There continues to be a number of critical tax issues that need to be addressed at the federal level.

Preparing recommendations

In preparing its recommendations, the Committee considered Albertans' advice received through the consultation process, a number of background papers, and briefing information on particular questions raised by Committee members or by individuals and organizations through their submissions.

Alberta Treasury prepared simulations for the committee on a variety of tax sytems based on Statistic Canada's "Social Policy Database and Model" (SPS D/M) and Revenue Canada tax statistics ("Taxation Statistics for Individuals 1995 - Alberta"; "Tax Statistics for

1996"). Calculation of foregone revenue, change in economic efficiency and measures of redistribution (reduction in after-tax income inequality) are also based on this model. Specific numbers can be expected to change over time.

The Committee's recommendations also were guided by a clear set of principles. Those principles reflect the earlier work published by the Alberta Tax Reform Commission in 1994.

In the first phase of its work, the Committee looked at some specific questions related to Alberta's competitive tax advantage and the impact of tax policies on knowledge-based industries. While the Committee acknowledged that other provinces had introduced specific tax incentives to attract certain industries, the Committee's overall conclusion was that this was not the best long term solution for Alberta since it impeded achieving the lowest possible rates for all taxpayers.

The Committee's view is that the best tax policy for Alberta is to pursue a deliberate policy of low rate, broad based taxes that benefit all Albertans and all sectors of our economy. That view was expressed in the Committee's phase 1 report and it is reflected in the recommendations included in this report. Not only is this the best policy for individual Albertans, but it also is the best way to encourage economic growth and investment for Alberta's future.

The best tax policy for Alberta is low rate, broad based taxes that benefit all Albertans and all sectors of our economy.

Seeking Advice

The Committee's review of personal income tax issues began in May 1998. Plans were made for seeking the advice of Albertans – both individuals and organizations – on the key issues involved in this review.

A background paper was prepared, providing information on how Alberta's personal income taxes are determined now and describing the advantages and disadvantages of moving to a new tax on income system.

Advertisements were placed in May in all daily and weekly newspapers throughout the province, identifying the key questions and seeking Albertans' advice. The background paper was made available to anyone who was interested as well as posted on the Alberta Treasury website. Copies of the background paper also were distributed to a number of organizations across the province. In total, 250 information packages were distributed to Albertans through the mail, via fax, or on the internet.

In addition to written submissions, Albertans also had the opportunity to make direct presentations to the Committee through four public meetings. Those meetings were held in Calgary, Edmonton, Lethbridge and Grande Prairie. Advertisements were placed to encourage people to attend meetings in those four communities.

In total, the Committee received 106 oral and/or written submissions. Of those submissions, 47 came from smaller cities and rural communities, 25 were from Edmonton, and 18 were from Calgary. The location for 15 submissions could not be determined primarily because the response was made via the Internet. One submission was received from outside the province.

A listing of oral and written submissions is included in Appendix 2. It portrays only the names of those who agreed that their names could appear in the report and consequently it does not represent all submissions received.

In addition to the submissions, the Committee also reviewed various reports, studies and analyses of various options. Much of that information is referred to throughout the report. Appendix 3 provides a list of reports and studies reviewed by the Committee.

Issues and Opinions

The following outlines the key issues addressed by the Committee and summarizes the views and opinions we heard as well as the additional information we reviewed in developing recommendations.

Should Alberta move to a tax on income approach?

What is the issue?

Under the current system, Alberta's personal income taxes are calculated as a percentage of basic federal tax. This arrangement dates back to 1962 and a series of agreements between the federal government and the provinces (except Quebec). Under those agreements, the federal government agreed to collect and administer provincial taxes at no charge, while the provinces agreed to accept the federally defined "Basic Federal Tax" as the base for provincial income taxes.

The result was a uniform tax base across the country with a single collection agency – Revenue Canada. On the one hand, the single collection agency, one tax return and a uniform tax base reduce compliance costs for taxpayers and administration costs for government. On the other hand, provinces are required to adhere to federal decisions regarding the calculation of taxable income and deductions, and to attach provincial income taxes to the federal tax brackets and rates structure. Provinces must also use federally defined amounts for non-refundable tax credits.

This lack of direct control over tax policy mechanisms has resulted in Canadian provinces introducing an array of surtaxes, flat rate taxes, and a variety of different provincial credits in an attempt to make adjustments reflecting provincial priorities. For example, Alberta has the selective tax reduction to provide greater tax relief than is provided under the federal structure to those people with lower incomes. In 1997, the province introduced the Family Employment Tax Credit. The province needed the federal government's approval and their agreement to administer the credit on Alberta's behalf.

Provinces have expressed concerns about the lack of flexibility in the current arrangements. As a result, the federal government has agreed that the provinces should have greater flexibility under the federal/provincial tax collection agreements, including the option for provinces to move to "tax on income" rather than setting provincial tax as a percentage of basic federal tax. The tax collection agreements would continue, retaining the advantages of federal collection and administration and the requirement to file only a single tax return. Taxable income would continue to be uniformly defined across Canada.

Tax on income means that the province could set provincial tax rates based on peoples' taxable income rather than how much basic federal tax they pay. This means more flexibility in setting tax policy, since provinces would have more direct control over a greater portion of the tax system for provincial purposes.

Alberta would decide how many provincial tax brackets to have, what the rates should be for each tax bracket, and the levels of specific tax credits provided for provincial purposes. Currently, Alberta can introduce additional credits, and this would not change. Alberta also automatically mirrors federally-defined levels of non-refundable credits (e.g. basic personal exemption, age credit, tuition, spousal deduction, etc.). Tax on income would permit the province to adjust the levels of existing non-refundable tax credits (with 1997 levels as minimum amounts) for provincial income tax purposes.

The difference between the current method of calculating Alberta income tax and a tax on income approach is outlined in the chart on page 12.

The essential commitment from government is that Albertans' taxes would not increase as a result of changing to a new personal income tax system. If we move to fewer tax brackets, with no other changes, some Albertans would pay more while others would pay less. In order to ensure that Albertans do not pay more in taxes, an overall tax cut would be required. The extent of the tax cut and the subsequent impact on government revenues would depend on the number of tax brackets, the rates set for each bracket, any adjustments to existing credit levels, and whether or not any extra specific tax credits are provided.

If Alberta chooses to move to a tax on income approach, the federal government would still collect provincial income taxes on the province's behalf. This means Albertans would still have only one tax form to complete. Alberta would not be required to set up and pay for a separate tax collection agency. While there would be some start up costs involved in setting up a new system, there would be no ongoing incremental costs to the province if Alberta adopts a tax on income approach.

Calculation of Federal and Alberta personal income taxes

FEDERAL

1) Total Income (employment, business and investment) ⇩

2) Net Income (Total income less: retirement savings, union dues, investment costs) ⇩

3) **Taxable Income** (Net income less: prior year losses, northern residents deduction) ⇩

4) Federal Tax (using federal brackets and rates) ⇩

5) Less Federal Non-refundable Credits (basic, married, age, CPP/EI) ⇩

6) **Basic Federal Tax (BFT)** ⇩

7) Plus Individual Surtax (3% of Basic Federal Tax less income tested adjustments) ⇩

8) Plus High Income Surtax (5% of Basic Federal Tax over $12,500) ⇩

9) Less Political, Investment, Labour-sponsored Funds tax credits ⇩

10) **Net Federal Tax**

ALBERTA

Current "Tax on tax"

6) **Basic Federal Tax (BFT)** ⇩

7) Basic Alberta Tax (44% of BFT) ⇩

8) Less Selective Tax Reduction for low income Albertans ⇩

9) Plus Flat Rate Tax (0.5% of taxable income for all Albertans) ⇩

10) Plus Surtax (8% of Basic Alberta Tax over $3,500 for higher income Albertans) ⇩

11) **Alberta Income Tax**

Proposed "Tax on income"

3) **Taxable Income** ⇩

4) Alberta Tax (using Alberta brackets/rates) ⇩

5) Less Alberta Non-refundable Credits (federal credits plus Alberta enhancements) ⇩

6) **Alberta Income Tax**

What views did the Committee hear?

The majority of those who commented specifically on tax on income supported moving to this new approach.

Arguments in support of moving to tax on income included the following:

> *"Since the federal government is providing the option to base provincial taxes on income, Alberta's Chartered Accountants recommend that Alberta take this opportunity to attain greater flexibility and autonomy in provincial tax policy."*
> - Institute of Chartered Accountants of Alberta

- **Provincial autonomy** – Many supported tax on income because it would provide the province with more autonomy in setting its own tax policy.

- **Control** – The province would also have more control over its personal income tax revenues. Under the current system of tax on tax, if the federal government decides to raise or lower income taxes, the province's income tax revenues are automatically raised or lowered. Tax on income would separate provincial revenues from federal tax changes. Alberta would also be able to fully index its brackets and non-refundable credits to inflation.

- **Flexibility** – Moving to tax on income would provide the province with more direct control over design mechanisms, enhancing the ability to achieve Alberta's economic and social objectives. There would be greater flexibility in setting bracket and rate structures, the income level at which taxes become payable, and the levels of other credits. The province also would be able to address specific issues of bracket creep and differences between single and double income families.

- **Accountability** – Simplifying Alberta's tax system and de-linking it from federal tax rates and brackets would make the province more accountable for its own tax policy decisions. The enhanced transparency would also give taxpayers a better understanding of the rate of tax they pay to each level of government.

- **Economic efficiency** – Moving to tax on income would provide the opportunity to more directly and neatly design a provincial personal income tax system which decreases economic costs.

- **Simplicity** – Moving to tax on income, especially with one or only a few tax brackets, would simplify Alberta's tax system. The flat rate tax, surtax, and selective tax reduction mechanisms could be removed, while the re-distributive functions of those mechanisms could be maintained.

- **Leadership** – Some respondents suggested that moving to tax on income is likely a trend other provinces will follow as well. Alberta could take a leadership role by moving to a new system and taking a significant step in national tax reform.

On the other hand, those who disagreed with moving to tax on income suggested the following:

- **Complexity** – Some suggested that people are familiar with the current system and any departure from federal tax brackets could make it difficult for taxpayers to understand and determine their own tax burdens. Introducing a new set of tax rules unique to Alberta would not be beneficial to consumers or to Alberta businesses.

- **No need for change** – Some suggested that the benefits of moving to a tax on income approach – particularly the benefits to individual Albertans – were not sufficient to warrant the change.

- **Simpler options** – Rather than changing the tax system, some suggested that the preferred option would simply be to remove Alberta's flat rate tax and the surtax. This would reduce complexity and also reduce taxes paid by Albertans.

- **Potential for tax increases** – Some submissions raised concerns that moving to tax on income could make it easier for future governments to raise taxes.

- **Administrative costs** – Several respondents objected to a new tax system because they assumed it meant Alberta would have to set up its own tax collection agency. As noted in the background paper and in this report, there would be no separate tax collection agency in Alberta; the federal government would continue to collect taxes on Alberta's behalf.

- **Problems with two tax systems** – Some suggested that, if Alberta moved to a different system from other provinces and the federal government, it may cause problems in inter-provincial comparisons and may make it more difficult for people to understand the tax system.

> *"... unless you can prove to the people of this province that it would save money and we could really benefit from the changes we should leave it as is."*
> - Gordon Briggs, Hillspring

- **Downside to flexibility** – Some suggestions were made that, while flexibility can be a good thing, we shouldn't encourage governments to make continual changes to the tax system. This kind of regular "tinkering" with the tax system adds confusion and makes the tax system more difficult for people to understand.

- **Transitional costs** – Provinces moving to a tax on income system would be responsible for covering Revenue Canada's costs in setting up a new system.

How many tax brackets/rates?

What is the issue?

Currently, the federal tax system has three brackets:

Taxable Income	Statutory Federal Tax Rate
\$0 - \$29,590	17%
\$29,590 – \$59,180	26%
\$59,180 and over	29%

> *"We have discussed this among ourselves – a flat tax rate system – and believe, despite some flaws, it's a much easier system to manage than the present system which is extremely complex. If you have the courage to move towards such a system, you would be recognized as true leaders in the field of tax reform."*
> - Councillor Tom Griffin, Ft. McMurray
>
> *"Movement to a flat tax system would be a major change in the tax system in Alberta. However, based on the results of our survey it is something that should be closely examined to determine if there are benefits to the people of Alberta from such a system."*
> - Certified Management Accountants

After calculating federal tax using these brackets and rates, non-refundable tax credits are subtracted to arrive at basic federal tax. Two specific surtaxes are then added. First, 3% of basic federal tax is added (adjusted for an income-tested reduction). Second, another 5% of basic federal tax is added for those whose basic federal tax is greater than \$12,500. This complicated system results in a range of actual federal tax rates, ranging from 0% to 31.32%.

In Alberta, the basic rate is 44% of basic federal tax. We then add on two extra charges, first introduced in 1987 as "temporary" taxes to help eliminate the deficit.[1] The first is a 0.5% flat rate tax which is levied against taxable income. The second is an 8% surtax on basic Alberta tax greater than \$3,500 and paid by Albertans with about \$46,450 or more of taxable income.

Alberta also provides several tax credits in order to reflect provincial priorities:

- ➢ The selective tax reduction increases the income which can be earned before people have to pay provincial income tax (from approximately \$6,500 to \$10,000 for a single individual).
- ➢ The Family Employment Tax Credit provides support to low and middle income working families.

[1] 1987 Alberta Budget

When federal and provincial rates and adjustments are combined, the result is an even more complex system, with an array of rates. Alberta's combined federal-provincial marginal rates (the rate paid on the last dollar of income) vary from 0 to 45.6%, depending on income, expenses and family type. Taking all the surtaxes, flat taxes and other adjustments into account, Albertans with taxable income above $63,400 pay federal tax of 31.32 cents and Alberta tax of 14.28 cents (a total of 45.6 cents) on their last dollar of income.

If Alberta moves to a new tax on income approach, it can decide how many tax brackets and rates to have. It can also do away with the surtax, the flat rate tax and the selective tax reduction and still achieve a similar or improved distribution in the tax burden.

What views did the Committee hear?

The majority of those who supported moving to tax on income suggested there should be as few tax brackets as possible. Many called for a single bracket as the best option. Some suggested that if the province moved to a single rate tax, the basic personal exemption also should be raised to ensure that fewer low income Albertans pay taxes.

On the other hand, the Committee also heard suggestions that the number of tax brackets should be increased. People who suggested more tax brackets argued that this is a fairer approach, allowing the province to set different rates for different categories of income levels.

Those who suggested more tax brackets argued that it provides a more progressive tax system – those who earn less pay a lower tax rate than those who earn more. Indeed, by implementing the surtax and selective tax reduction, and thereby effectively adding two more "brackets," Alberta has enhanced the progressivity of the federal system.

"We conditionally recommend one tax bracket because it would provide an overall long-term gain for the province."
- Institute of Chartered Accountants of Alberta

"We should institute a flat tax rate ... If you are really serious about private sector job creation and becoming less reliant on resource revenue, then stop punishing success through the tax code."
- Dr. W. Reynolds, MD, Grande Prairie

"The introduction of a 'tax on income' would allow the Province to adopt a system from scratch. Treat everyone the same with respect to the percentage."
- Larry Kirkpatrick, St. Albert

Others argue that income redistribution can be accomplished by other means and that high marginal tax rates can be a disincentive to working harder and earning more, and to retaining and attracting mobile, skilled professionals. They claim a single tax rate with no exemptions is the fairest and simplest approach and that increasing the level where income tax becomes payable achieves the objectives of a progressive tax system. A single rate system also would help to address differences between taxes paid by single and double income families.

Considering specific tax credits

What is the issue?

One of the advantages of moving to a tax on income approach is the flexibility that the province would have in adjusting the levels of existing non-refundable tax credits to address specific issues. Tax credits for age, medical expenses, children, or the costs of tuition, for instance, increase fairness in the tax system by recognizing a number of factors that reduce a person's ability to pay taxes. Tax on income would give Alberta more control over these tax policy tools.

> *"I am hard pressed to think of any new deductions or tax credits that we particularly need as Albertans. Most of the areas I can think of such as tax credits for students, the disabled or senior citizens are well addressed by the current federal system."*
>
> \- John Henderson, Chartered Accountant

Alberta would continue to have the ability to introduce its own tax credits, in addition to the non-refundable credits provided by the federal government.

At the same time, introducing additional tax credits complicates the tax system, and adds economic and administrative costs. Specific tax credits affect the share of tax each person pays, making it more difficult to provide the lowest possible taxes for all. Revenue Canada will charge the province to recover its costs for administering any extra credits not harmonized with its own. The question is whether the policy benefits attained through implementing distinct Alberta tax credit initiatives are worth the costs.

What did the Committee hear?

Opinions were divided on the use of tax credits.

On the one hand, many respondents argued against tax credits, suggesting that they add complexity and compliance costs to the tax system.

On the other hand, many respondents suggested that tax credits were an essential way to retain a fairer tax system. Most supported tax credits for age, medical expenses, tuition and charitable donations. A number of suggestions were also made for introducing new tax credits for the disabled or for low income earners based on total family income.

Addressing tax differences between single and double income families

What is the issue?

A number of submissions to the Committee raised the issue of differences between income taxes paid by single and double income families. Since the basic tax unit in Canada is the individual rather than the family, two income families have a lower income tax burden than single income families at comparable levels of family taxable income. This difference is due to several factors:

- Tax rates increase as incomes rise. That means a single earner is taxed at higher rates than a double income family making the same amount. For example, one earner making $60,000 pays more in income tax than two earners making $40,000 and $20,000 even though the family's income is the same. This is the most important source for the differential in taxes paid for families with incomes over $30,000.

- The non-refundable credit for the spousal amount is lower than the basic personal amount. Single income earners can only claim one basic personal amount and the lower spousal amount, while double income earners can both claim the higher basic personal exemption. This factor is the most important source for the differential in taxes paid for families with incomes under $30,000.

- Two income families can claim a deduction for child care expenses. Currently, families are allowed to claim child care costs up to $7,000 for children under the age of 7 and $4,000 for children between the ages of 7 and 16. Single income families where one of the spouses stays at home to look after the children don't have these expenses and therefore can't use the deduction.

Comparison of Current Tax Burden for Single and Double Income Families (Two Children)

	Two Income Family (60/40 split)	One Income Family
Family Income	$60,000	$60,000
Minus Taxes:		
Federal Income Tax	$7,273	$10,849
Federal Payroll Tax (EI/CPP)	$3,316	$2,122
Child Tax Benefit	($586)	($336)
Alberta Income Tax	$3,428	$5,052
After-tax Income:	$46,569	$42,313

Source: Alberta Treasury

The above chart shows a difference of $4,256 in after-tax dollars for two families earning the same income. In calculating the tax liabilities, it is assumed that the two-income family has child-care expenses of $5,000. This $5,000 expense has not been subtracted from their after-tax income.

The key issue is whether or not this difference in taxes is appropriate.

What did the Committee hear?

Those who argue against the current differential tax treatment believe this type of difference:

- Is too large.
- Places an unfair burden on one-earner families.
- Tilts incentives towards fee-charging, non-parental child care rather than parental care. They argue that this may have social

costs, such as undermining family stability and increasing the risk of behavioural problems in children.

On the other side of the debate, it is argued that:

- The tax differential is more than offset by the additional costs of child care expenses incurred when both parents are working.
- The tax system should recognize additional costs faced by two-income families.
- There is value in individual financial autonomy for both parents, including the ability of each spouse to contribute to pension plans.
- Economic productivity is improved through an expanded labour force. The tax system should not discourage highly skilled spouses from entering the workforce.

The majority of submissions on this issue argued that the tax system should remove the current differences and recognize the benefits of having one parent stay at home to care for their children. Specific suggestions for reducing or eliminating the differences in income taxes paid by single and double income families included the following:

- Allow single income families to split their income with the spouse who works in the home. This would have the added benefit of providing the spouse with an income and a degree of financial independence. For example, concerns were expressed to the Committee about the ability of stay-at-home parents to make pension contributions.

- Extend the same child care deductions or child tax benefit to all families including both single income and double income families. This would mean that the same deductions, benefits or credits would be available for every child regardless of whether the child is cared for in day care or in the home.

"The bottom line is that Canada's tax system short-changes traditional single-income families, where one spouse stays at home to look after the kids. Whether as a result of circumstance or choice, these families end up paying the price for not having both parents in the work force."

- Jason Kenney, *"Why aren't all families taxed equally?"*, Kids First Newsletter, Fall 1997

" The condition of Alberta's families, and specifically its children, will naturally have a tremendous influence on the quality of life of future generations of Albertans. Therefore, any effort to improve the province's tax system must take into account the considerable influence tax policy has on family structure and functioning."

- The National Foundation for Family Research and Education

- Increase the spousal allowance to the same amount as the basic personal exemption.

- Make the family the unit of taxation as opposed to the individual.

Reducing or eliminating "bracket creep"

What is the issue?

> *"Once proper inflation adjustments are back in the tax code, governments that would like to appropriate an ever-larger share of Canadians' income will have to do so by explicit policy action, rather than by allowing inflation to do the dirty work."*
>
> \- Finn Poschmann, *"How Do I Tax Thee? Choices Made on Federal Income Taxes"*, C.D. Howe Institute

In Canada, tax brackets and deductions were indexed for inflation from 1974 to 1986, but have only been partially indexed since then. Adjustments for inflation are only made to the extent that inflation exceeds 3%. For example, if inflation is 4%, a 1% adjustment would be made to tax brackets and credits. Because of relatively low inflation rates, no adjustments have been made since 1992.

This lack of full indexation means that more and more Canadians who received wage increases equal to inflation are being pushed into higher tax brackets and paying more tax — even though their purchasing power has not increased. The tax reform of 1988 reduced the number of tax brackets and converted some deductions to non-refundable tax credits. Estimates are that, on an annual basis, federal personal income tax revenues will be $10 billion more in 1998 because of the lack of full indexing since this tax reform. There will also be an increase in provincial personal income tax revenues.

Over the past ten years, about 1.4 million Canadians became taxable through increases in their nominal rather than their real incomes. Bracket creep pushed a further 1.9 million individuals from the 17% tax bracket into the 26% bracket, and moved 600,000 more people from the 26% rate to the 29% bracket.[2]

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[2] Organization for Economic Co-operation and Development (OECD), "OECD Economic Surveys 1996-97, Canada" November, 1997, p. 112. These rates refer to only federal rates. Combined federal and provincial rates are higher.

Impact of bracket creep on taxes paid by Canadians

	Taxable Income for moving from 17% to 26% federal tax bracket			Taxable Income for moving from 26% to 29% federal tax bracket		
Year	**Actual**	**If fully indexed**	**Out-of-pocket tax cost***	**Actual**	**If fully indexed**	**Out-of-pocket tax cost***
1988	$27,500	$27,500	$ -	$55,000	$55,000	$ -
1989	27,803	28,628	157	55,603	57,255	231
1990	28,275	29,973	323	56,550	59,946	476
1991	28,784	31,412	501	57,568	62,823	737
1992	29,590	33,234	694	59,180	66,476	1,022
1993	29,590	33,931	827	59,180	67,863	1,218
1994	29,590	34,542	944	59,180	69,084	1,390
1995	29,590	34,784	989	59,180	69,568	1,456
1996	29,590	35,375	1,002	59,180	70,751	1,623
1997	29,590	35,941	1,210	59,180	71,883	1,782

* The tax cost assumes a provincial tax rate of 50% of basic federal tax. Note also that KPMG has not factored in the effects of federal or provincial surtaxes, which would further increase the tax cost of bracket creep.

Source: KPMG *"The Tax Cost of 'Bracket Creep"*, Canadian Tax Notes, June 20, 1997

The above table displays just how much in extra taxes Canadians are paying and governments are collecting. An individual earning $27,500 in 1988, whose wages grew only at a rate equal to inflation, would have made $35,941 in 1997. In 1988, that person's income would all have been taxed at the lowest federal rate of 17%. Yet, because of bracket creep, $6,351 of that person's income in 1997 was taxed at the federal rate of 26%, and the basic personal exemption was worth less. The total extra federal and provincial taxes this individual paid in 1997 was $1,210, even though the purchasing power of the person's income is the same.

> *"If this 'cradle-to-grave' robbery is not fixed, in just a few short decades every working Canadian will be paying income tax at the top marginal rate."*
> - Finn Poschmann, *"How Do I Tax Thee? Choices Made on Federal Income Taxes"*, C.D. Howe Institute

What makes bracket creep even more disturbing is that while average tax levels have increased at all levels, they have increased proportionately more for those with low and middle incomes.

What did the Committee hear?

There is growing recognition of the problem of bracket creep. A number of submissions suggested that moving to tax on income is one way that Alberta could address the problem within the province.

Raising the basic personal exemption level

What is the issue?

"It is ludicrous that taxes are charged on income of less than $10,000, an amount totally inconsistent with the cost of living in any part of Canada/Alberta."
- Norbert Salamon, Olds

"I favour an income tax system which provides a substantial per person basic exemption, and a flat tax rate on remaining income without loopholes: a fair, simple system that ensures that people with more income pay more tax, without inefficient, unfair ways to avoid tax. An Alberta 'Tax on Income' could approach this ideal ..."
- Les Hofer St. Albert

Currently, the basic personal exemption level is set at $6,456. People whose taxable income is less than that amount pay no federal taxes. In Alberta, the selective tax reduction allows us to increase the taxable income at which people start paying provincial income taxes to about $10,000. The result is that more low income Albertans are exempt from paying provincial income taxes.

The rationale for Alberta's selective tax reduction is to assist lower income taxpayers and to ensure that they are able to support themselves and pay for essentials. It is difficult, however, to estimate just what income level is appropriate. There are various ways of determining "low income" levels or levels below which people cannot support themselves, and the levels vary from province to province. Statistics Canada has several measures, such as the Low Income Cut-Off and the recently developed Low Income Measure, but these measures have been questioned as yardsticks against which to judge a person's ability to pay for basic needs. However, regardless of the particular measure used, the range is typically from $12,500 for a single individual to over $22,000 for three people.

Under a tax on income system, the province could more easily and directly set an appropriate basic exemption level. There would no longer be a need for the complicated calculation for the selective tax reduction.

What did the Committee hear?

The Committee received a number of submissions that suggested increasing the basic personal exemption level. The thresholds they suggested ranged from $12,000 - $20,000. This is within the range of yardsticks used to measure a person's ability to pay for his or her basic needs.

> *"Some relief for the working poor is necessary. One simple method of relief is to have a reasonably high minimum household income prior to any tax being collected. Example: the first $18,000 should have no income tax."*
>
> \- Rick Bunowiz

The key argument that Albertans made was that people at lower incomes should not have to pay income tax and that boosting the exemption amount would be a direct method of accomplishing this goal. It also would make it easier to move to a flatter and more simplified tax system with a minimum number of tax brackets and tax rates, while maintaining or enhancing the existing progressivity of the tax system.

Addressing high marginal tax rates

What is the issue?

Marginal tax rates are the rates of tax an individual pays on the last dollar of income earned. When measuring the economic impact of taxes on individual decisions to work, save or invest, most economists agree that marginal rates have the greatest impact. That's because they directly affect incentives such as returns on individual investment and work effort. High marginal rates at any income level discourage people from working harder and earning more, and are therefore a drag on economic activity.

> *"We're a company that's subject to the brain drain and we're losing very good people. Unfortunately, these days, a good chunk of graduating classes are moving south to take their first jobs. The income taxes make a big difference, a negative difference, to Canada."*
>
> \- John Wetmore, President of IBM, Canada Ltd. Quoted in the *Edmonton Journal*

One goal of increasing tax rates as income rises is the redistribution of income — from the higher income earners to those at the lower end of the scale. But when the rates on upper income earners reach a level where they create disincentives to productivity — in effect, punishing effort and success — the goal of redistribution is thwarted. Not only is overall economic output dulled, but people spend resources attempting to avoid taxes, or simply move to lower taxed jurisdictions.

Marginal tax rates are considered important as well in a nation's ability to attract and retain the skilled labour that is essential in today's technical global economy. Productivity gains are in large part driven by innovation and entrepreneurship, and these types of activities are usually performed by skilled, highly mobile, people.

1995 Marginal Tax Rates by Income Level (single person)
G - 7 Nations

	66% of APW*	100% of APW	200% of APW**
Canada	31.4	45.9	48.1
U.S.	29.9	29.9	42.9
Japan	15.0	19.4	28.1
Germany	51.2	52.6	49.6
France	35.0	35.6	43.3
Italy	34.3	34.3	41.1
U.K.	35.0	35.0	40.0
G - 7 Average	33.1	36.1	41.9

* Average Production Wage
** Above this income level, capital income is likely to be significant

Source: OECD Economic Outlook 61 (June 1997), p. 36.

In terms of international comparisons, Canada's marginal tax rate is below the average for the major industrialized nations and third lowest for lower income single taxfilers. We jump to second highest for singles at the average production wage (around $30,000 for Canada), and maintain that ranking for singles earning twice the average production wage.

Canada's proximity and relationship with the U.S. make it important to compare our rates with the U.S. Our marginal rates are much higher than the U.S. at the average production wage, and are also greater at double the average production wage.

A critical concern is the income level at which the top marginal rates apply. In Canada, the top marginal rate is triggered at about $64,000 of income while in the United States, it applies to those making US$278,000. As the chart below shows, Canada's top marginal rate kicks in at a substantially lower income level than most other G-7 nations. Alberta's combined federal/provincial top marginal rate is 45.6% at $64,000.

Incomes at which top marginal tax rates become payable in G -7 Nations (National governments, 1995 tax systems)

	Income level where top marginal personal income tax rate of national government applies ($ Canadian)*
Canada	$ 64,000
U.S.	400,000
Japan	347,000
Germany	229,000
France	79,000
Italy	289,000
U.K.	64,000

* exchange rates as of 5 October, 1998 *Globe and Mail*

Source: Alberta Treasury, using Ernst & Young, *"Executive Tax Guide and Directory,"* 1996 edition.

A comparison of top marginal tax rates for Canadian provinces shows that marginal tax rates in Alberta are lower than other provinces.

Top marginal tax rates in Canada, 1999 (single earner)

Province	**Top federal rate (%)**	**Top provincial rate (%)***	**Federal abatement (%)**	**Total (%)**
Alberta	31.32	14.28		45.60
New Brunswick	31.32	18.01		49.33
Ontario	31.32	18.32		49.64
Nova Scotia	31.32	18.34		49.66
Manitoba	31.32	18.50		49.82
PEI	31.32	18.98		50.30
Saskatchewan	31.32	19.90		51.22
Quebec	31.32	26.00	- 4.79	52.54
Newfoundland	31.32	22.01		53.33
British Columbia	31.32	22.39		53.71

* Top combined federal/provincial marginal tax rates take effect at different income levels, generally between $64,000 and $80,000.

Source: Alberta Treasury

> *"Without question, the largest loss of Alberta professionals and skilled individuals is to the United States. Therefore, if Alberta wishes to stem this tide, the Province needs to eliminate the unlevel playing field that is causing this migration ... Alberta should at least attempt to create a ... tax regime (for high income earners) that closely resembles that found in the U.S."*
> - Certified Management Accountants

> *"... excessive marginal tax rates flowing from means-tested credits and benefits hurt efforts by Canadians with modest incomes to get ahead, while the marginal rates on higher incomes are crippling Canada's ability to compete for skilled people and jobs in a global, knowledge-based economy."*
> - Business Council on National Issues

What did the Committee hear?

The Committee heard suggestions that marginal tax rates should be lower and should apply at higher levels of income. Both of these actions would improve Alberta's ability to attract and retain a highly skilled workforce.

Several submissions reinforced the problems certain industries, such as knowledge-based/high tech industries, are having in hiring and maintaining the skilled workers they need. We are losing capable people to the United States, in part because of substantially lower marginal tax rates for high income earners.

As the OECD warned in its 1997 review of Canada, this could make it more difficult to attract and retain highly skilled persons who are likely the most mobile internationally.[3] As an example, Canadians start paying the top tax rates on such a low level of income that university graduates in disciplines such as engineering and computer science may face those high tax rates within one or two years of graduating.[4] Many of these highly mobile "knowledge-based" workers have been trained and educated at publicly-funded post-secondary institutions at considerable expense.

Some Albertans pointed out that Canada's high marginal tax rates encourage increased avoidance and evasion of taxes. Finally, the Committee was presented with the thought that we could be the beneficiaries of a "brain gain" – highly skilled people moving to the province – if the province were able to lower marginal income tax rates.

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[3] Ibid., p. 103

[4] *"Creating Opportunity, Building Prosperity - A Tax Reduction Strategy for Canadians"* - Business Council on National Issues, p. 22, October 1998

Reducing personal income taxes

What is the issue?

Albertans pride themselves in having the lowest overall taxes in the country, and in paying no provincial sales tax. But in today's rapidly changing, inter-connected world, national tax comparisons are losing their significance. Alberta must compare its overall tax burden to other nations and jurisdictions.

Low taxes are important not only because of the benefits to individual Albertans and their families but also because they help the province compete in the business of attracting and increasing investment and promoting growth in the province's economy. Knowledge-based industry investment and the people who have the technological skills and ideas are able to locate wherever their efforts are best rewarded.

The Committee also recognizes that taxes pay for government programs and services, and that different tax levels may fund different amounts, types and quality of public services. It's important to take this factor into account in comparing tax burdens.

On the other hand, there are those who argue that too much taxation leads to unnecessary services, and that the services may not be provided in a cost effective manner. They say that when tax levels get too high, a point is reached when a dollar in the hands of government is not as productive as that same dollar may be in the hands of a taxpayer.

In comparison with other countries, Canadians tend to pay much higher income taxes. According to Statistics Canada information, income taxes consumed a record 20.5 percent of family total income in 1996. And the use of personal income taxes has grown. "Real average income after tax for

> *"We believe that significant reductions are needed in the level of personal income tax not only to retain the people we have but also to attract the people we need to meet our future growth projections for the oilsands industry."*
>
> \- Phil Lachambre, Syncrude

> *"Alberta's Chartered Accountants favour an overall lower income tax burden so that Albertans can direct how their income and wealth is utilized, whether from investment or charity. The philosophy of government should be to leave more wealth in the hands of individuals and let them decide how to use it. This approach would maximize economic activity, which will generate more government revenue long term."*
>
> \- Institute of Chartered Accountants of Alberta

families in 1996 was nearly 5% lower than in 1980."[5] Canada now depends more on personal income tax than any other G-7 country.[6]

Tax mix: taxes as a % of total taxation G - 7 Nations, 1995

	Personal Income	Corporate Income	Social Security Levies*	Property**	Goods and Services***
Canada	37.3	8.1	16.8	10.5	25.5
US	36.3	9.4	25.1	11.2	17.9
Japan	21.4	15.2	36.3	11.6	15.1
France	13.9	3.7	43.3	5.2	27.3
Germany	27.3	2.8	39.4	2.8	27.8
Italy	26.2	8.7	31.7	5.7	27.3
UK	27.4	9.5	17.7	10.5	34.7

* Payroll taxes paid to fund specific social security programs (eg. CPP, EI)
** Includes inheritance and wealth taxes
*** Consumption, sales, excise, resource extraction and processing taxes
Note: Individual rows do not add up to 100% as miscellaneous small taxes are not included.
Source: OECD Revenue Statistics 1965-96, Tables 11,13, 15, 23, 25

Even though Alberta stacks up well against other Canadian provinces, the Alberta personal income tax burden is heavier than those of several states, for all but lower income levels.

Average personal income tax burden (%) faced by selected families - Alberta and U.S. States

Families with two children	Single income $30,000	Double income $55,000	Double income $100,000	Single income $300,000
Alberta	4.3	17.0	25.8	40.3
California	6.0	12.3	22.1	37.4
Idaho	7.3	14.3	23.0	37.2
Montana	8.3	13.8	23.1	35.4
Texas*	5.7	9.9	17.0	29.5
Washington*	5.7	9.9	17.0	29.5
Ohio	7.6	12.1	20.2	35.4
New York	8.8	15.9	25.3	39.8
Alberta Rank	Lowest	Highest	Highest	Highest

* Texas and Washington have no state personal income taxes.
Source: Alberta Treasury

[5] Statistics Canada, *"The Daily - Family income after tax, 1996"* (Catalogue #11-001E), June 22, 1998

[6] OECD *"Economic Surveys 1996-97, Canada"* p. 72

What did the Committee hear?

Many Albertans told the Committee that, regardless of the type of tax system we have in Alberta, the objective should be to improve Alberta's advantage by having low taxes. Several groups, including the Institute of Chartered Accountants and the Canadian Taxpayers Federation, supported an overall lower income tax burden on Albertans so that individuals would be able to decide themselves how to use their income and wealth. The philosophy of leaving more money in the hands of individuals was supported by many submissions.

The Committee also heard that high personal income taxes are a particular issue for Canada in comparison with other countries.

"When the federal and provincial guidelines were set, people earning over $30,000/$50,000 were considerably well off. Today, $50,000 family earnings, with a stay at home mom, and children in higher education, and often child support coming from that income, it does not leave the family with enough left over to live comfortably."

- Bernadette Christie, Grande Prairie

"High levels of taxation do more than take money out of the pockets of Canadians. Generally, they reduce investment, job creation and economic growth. ... The level and structure of Canadian taxes has not only slowed growth; in hampering the country's competitiveness, it also has contributed to the steady decline in the value of the Canadian dollar and in the standard of living of all Canadians."

- Business Council on National Issues

Re-considering Alberta's temporary deficit elimination taxes

What is the issue?

> *"The flat tax and the surtax should be the first targets for elimination as this would not add complexity and would enhance the 'Alberta Advantage'."*
> - Irene Pfeiffer, Calgary Chamber of Commerce

Alberta has a flat rate tax of 0.5% levied on taxable income which is paid by every Alberta taxpayer, and an 8% surtax that is paid by taxpayers with taxable incomes over $46,450. Both of these taxes were introduced in 1987 as temporary tax measures to help the province eliminate the deficit. These two temporary taxes raise approximately $350 million per year.

What did the Committee hear?

Many people said that these two temporary taxes should be eliminated, whether or not government decided to move to a new tax on income system. This would provide a direct benefit to all Alberta taxpayers and also simplify the tax system.

Addressing challenges for a future tax system

In addition to the specific issues raised with the Committee, there are a number of important challenges the province will need to address as we look ahead to a future tax system.

- **Electronic commerce**

  The development of electronic commerce is changing the way businesses operate. As more business transactions, sales and services are provided through the Internet, there are important questions for Alberta, Canada and international tax systems to address.

  As the OECD notes, "a physical presence is no longer necessary to perform activities, but international tax principles rely on concepts such as 'physical presence' for direct taxes or 'place of establishment' for value added tax purposes. The development of

electronic commerce also has the potential to create a parallel banking system outside of conventional banking channels. A key question for governments is how the development of electronic commerce relates to the current tax system, including substantive principles of direct and indirect taxation, as well as increased opportunities for tax avoidance and evasion, and issues of tax administration."[7]

A recent OECD report on *"Electronic Commerce: The Challenges to Tax Authorities and Taxpayers"* summarizes some of the key challenges as follows:

- Establishing identity – The identities of parties to a business transaction may be difficult to determine.

- Establishing location – Individuals and entities engaging in electronic commerce will be able to establish an Internet address in almost any taxing jurisdiction irrespective of the location of his or her residence or the source of activities.

- Obtaining acceptable documentation of proof - Obtaining information will become more difficult when activities are carried out in other taxing jurisdictions.

- Elimination of the "middle men" (disintermediation) – Traditional banking systems which today are characterized by a small number of very large banks, may be transformed by the availability of a large number of banking facilities on the Internet operating in an off-shore environment. This may make it more difficult for tax authorities to "piggy back" on the reporting requirements that Central Banks traditionally place on their domestic banking sectors.

- Tax havens and off-shore banking facilities – These will become more accessible and it will be increasingly easy for the "average" taxpayer to use offshore financial centres.[8]

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[7] OECD website - *"Electronic Commerce and Taxation"*

[8] *"Electronic Commerce: The Challenge to Tax Authorities and Taxpayers"* - OECD Round Table discussion paper, November 1997

These issues are complex ones which will have a dramatic impact on traditional tax policy. Within Canada and around the world, the impact of electronic commerce on tax policy is being addressed. The federal government has established an Advisory Committee on Electronic Commerce which is directly involved in reviewing this issue.

At this point, there are a number of studies and discussions underway and a clear consensus that problems need to be addressed, but there is no consensus on which tax approaches would be most effective.

The Committee has considered these questions and reviewed a number of studies and reports. While the Committee is not in a position to make any recommendations, it is important to flag this important issue as one that will need to be addressed in future, not only in Alberta but around the world.

- **The changing nature of work**

In many ways, our income tax system is based on an environment where the majority of people are employed in jobs, either full time or part time. Today, we are seeing significant shifts in the nature of work. More people are self employed, work on contract, or provide assistance on a project basis. Their income is flexible and sometimes difficult to predict. With an increasing shift to a knowledge-based economy, both people and resources are highly mobile and can choose to locate in low tax jurisdictions and provide services around the world. Changes in how people are paid using electronic banking systems will also pose challenges for how income can be taxed in the future.

Alberta's and Canada's future tax system will need to be flexible enough to respond to the challenges posed by different styles of work and the impact that has on individual and family income.

- **International trends to consumption taxes**

Several submissions to the Committee highlighted international trends toward more reliance on value added taxes (consumption

taxes) and less on personal income taxes. Arguments were made about of moving to consumption taxes as a preferred alternative to personal income taxes. It was also suggested that a better tax policy for Alberta would be to eliminate personal income taxes entirely and introduce a single consumption tax on all goods and services.

This issue was addressed in the Alberta Tax Reform Commission's 1994 report. The Commission indicated that, in the longer term, the best tax mix for Alberta would include the lowest possible personal and corporate income tax rates and a modest broad-based consumption tax. The Commission did not recommend a consumption tax but suggested that, once the budget was balanced, the issue of a consumption tax, combined with a substantial decrease in personal and corporate income taxes, should be discussed and debated in Alberta.

Around the world, the trend appears to be in favour of introducing or increasing consumption taxes rather than income taxes. In the United States, however, the federal government does not levy a consumption tax, but individual states do.

Arguments were made that a broad based consumption tax combined with substantial reductions in or elimination of personal income tax would provide Alberta with a better tax advantage. A 1% consumption tax[9] in Alberta would raise about $330 million in revenues. With an Alberta consumption tax of 10 – 12%, the province could virtually eliminate provincial personal income taxes entirely. These figures do not take into account any incremental economic activity (and therefore increased tax revenues) which may occur.

"The nearly universal introduction of the value-added tax (VAT) should be considered the most important event in the evolution of tax structure in the last half of the 20th Century."

- Sjibren Cnossen, *"Global Trends and Issues in Value Added Taxation"*, International Tax and Public Finance, 5, 399 – 428 (1998)

"In the last twenty years, there has been a steady trend for OECD . . . nations to develop efficient and competitive consumption tax systems (sales tax, value added tax, or goods and services tax). Other Canadian provinces and the USA are examining possible changes. Alberta must stay abreast of these changes and maintain all options that may be necessary to ensure our economy can meet the challenges of change."

- Sales Tax Harmonization, Comments by Alberta's Chartered Accountants,

[9] Estimates of consumption tax revenues are based on the federal GST tax base.

Arguments in favour of consumption taxes include:

- Relatively low-rate consumption taxes levied on a broad base are more neutral in their impact than the current personal income tax system. For instance, they don't produce the same disincentive effects on work effort that high marginal personal income taxes do.
- Since they are a tax on consumption, they do not discourage investment. Capital would earn a greater return for investors and therefore Alberta would attract more investment.
- Switching from personal income taxes to consumption taxes would reduce the resources and time spent on tax planning and tax avoidance.
- Lower personal income taxes would reduce the brain drain and expand the tax base.
- Consumption taxes are a more economically efficient method of raising an equivalent amount of revenue than income taxes.
- Consumption taxes may be a better mechanism for addressing issues related to electronic commerce, although the Committee also received contrary views. As noted earlier, there is no consensus on this issue.

There are others who disagree with these arguments. The Committee certainly appreciates that Albertans take great pride in the fact that we're the only province with no sales tax. However, because there may be potential advantages to a consumption tax, the issue may warrant further discussion and debate by Albertans. Under current law, a province-wide referendum and majority support would be required before a sales tax could be introduced in the province.

Considering other issues

In addition to the key matters analyzed above, the Committee was also presented with the following ideas:

- Eliminate health insurance premiums or allow Albertans to deduct health insurance premiums on their income tax.
- Make property taxes deductible against personal income tax.
- Eliminate school property taxes and fund education completely through the general revenues of the province.
- Reinstate an exemption so seniors don't have to pay education property taxes.
- Increase the personal income tax credit for charitable contributions.
- Consider introducing more user fees as a way to raise revenues and reduce income taxes.
- Consider a tax credit for student assistance specifically targeted for students from rural Alberta.
- Consider changes to capital gains taxes paid by Albertans.
- Maintain the Northern Residents Allowance currently provided by the federal tax system to compensate for the high costs of living in northern regions.
- Introduce tax credits for the disabled.

These issues were not specifically addressed by the Committee. In many cases, the issues go beyond the scope and mandate of the Committee's work. In others, the issues are addressed in a broad way through other recommendations of the Committee.

Starting from Principles

As a starting point for its recommendations, the Committee supports the following principles. These principles reflect earlier work done by the Alberta Tax Reform Commission.

- The tax system should promote the economic prosperity of individual Albertans.
- Taxation should provide the necessary revenues to pay for only essential government programs and services.
- The tax system should be stable, predictable, efficient and fair.
- The tax system should provide a level playing field.
- The tax system should be related to both the ability to pay and the overall benefits received.
- The tax system should be simple, visible, effective and accountable.
- The tax system should support and enhance Alberta's and Canada's competitive position.
- The tax system should require the minimum amount of administration.

These guiding principles are supported by the Committee and have been used as a framework for our recommendations.

> *"Ottawa's tax system is a mystery to everyone, and Alberta's system can only be called 'convenient' at best. A fair, and clear system is needed for the share we give to our province."*
> - Kelly Lee, Hythe

The need for simplicity was a primary consideration for the Committee. Submissions to the Committee repeatedly stressed the need to keep the tax system simple. Too many Canadians and Albertans are confused by the complexity of the current system and too few understand how their taxes are determined.

In weighing the various options and alternatives, the Committee considered in each case whether the benefits of moving in one direction or another could be justified if the result was to add further complexity to an already complex system. The general rule followed by the Committee was that whatever changes were made to the tax system, the end result should be a simple and straightforward Alberta tax form that is no longer than one page.

In a similar vein, the Committee also considered the possible advantages of having Alberta establish its own tax collection agency independent from the federal government. Currently, Quebec is the only province that collects its own personal income taxes. While there may be some advantages in having more autonomy over tax collection, members of the Committee concluded that the additional administration costs, and the complexity of having Albertans complete two separate tax forms, did not justify establishing a separate tax collection agency in Alberta. The preferred alternative is to continue to have a single collection agency administer both federal and provincial personal income taxes.

The Committee is concerned that the tax system has to be fair, and it has to be perceived to be fair. Albertans, and Canadians in general, are prepared to pay their fair share of taxes to support essential programs, as long as they perceive that others are not able to get particular tax breaks or avoid paying their fair share of income taxes. If the tax system is not seen to be fair, people will be less inclined to comply with tax laws and more inclined to find ways of avoiding paying tax.

> *"The hardest thing in the world to understand is the income tax."*
> - Albert Einstein

The Committee is of the view that personal income taxes should not act as a disincentive or discourage people from working hard and wanting to get ahead. A broad based, low rate tax system is the best way of encouraging and rewarding success.

Finally, a number of submissions made reference to basic questions about the purpose of personal income tax policy. Some suggested that the primary purpose is to raise revenues to support essential programs and services. In their view, tax policy should not be used as an instrument for social policy. Those who argued this position tended to support a much more simplified system with few or no tax credits designed to achieve certain social policy ends. This view has been expressed by the OECD:

> A growing consensus is emerging that, given the adverse incentive effects of progressive taxation and its consequences for compliance, the income tax rate structure should not be too steep... At the same time, it has been increasingly recognised

> that a substantial amount of redistribution, perhaps the lion's share, takes place through the expenditure side of the budget.[10]

On the other hand, there are those who believe that any tax policy is social policy, and that the tax system should be used actively as a vehicle for social policy. They supported an even more progressive tax system geared to redistributing income more than it presently does, and a system which addresses the needs of particular groups through tax credits or other adjustments.

The Committee's view is that taxes are primarily a vehicle for raising revenues. To the extent possible, social policy issues should be addressed through the programs and services government provides, not through the tax system. At the same time, the Committee recognizes that there are a number of issues that should be recognized in the tax system. In some cases, it also is more efficient and less costly to address a particular problem through the tax system rather than by adding a specific program or service.

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[10] OECD Economic Surveys 1996-97, Canada (see Note #6), p. 88

Recommendations

Based on its review of the various issues and alternatives, the Committee has prepared the following recommendations. The Committee recognizes the essential role provincial taxes play in supporting public programs for Albertans. The Committee supports lower personal income taxes for a number of reasons but, at the same time, believes that a sufficient, sustainable level of resources must continue to be raised to fund quality services for Albertans. That overriding view applies to all of the following recommendations.

Recommendation 1

> ***The province should reduce personal income taxes within Alberta and continue to encourage the federal government to lower taxes to improve Canada's competitive position.***
>
> **Rationale:**
>
> The Committee consistently heard concerns about the impact of taxation rates on Canada's and Alberta's competitive position. While many of these concerns relate to federal taxes, we strongly urge the provincial government to reduce personal income taxes and to continue to encourage the federal government to tackle pressing problems with the federal tax system.
>
> High marginal and average tax rates have an impact on Canada's ability to attract and keep the brightest people and the best jobs. As noted earlier in this report, Canada is at a distinct disadvantage compared to the United States. High income earners not only pay lower marginal tax rates in the U.S., but the income levels at which these top marginal rates begin are also higher in the U.S.
>
> High marginal rates of personal income tax also have negative consequences for productivity and economic growth, as they affect work incentives. In a related fashion, they discourage investment in our province and country. While taxes are but one factor in business location decisions, labour costs are one of the most important. Higher personal income taxes usually mean employees demand higher wages.

The Committee's view is that if action is not taken, Alberta and Canada will become less competitive. The Committee's recommendations would address problems of high marginal and average tax rates in the province and improve our competitive position.

Recommendation 2

The province should move to a new system of tax on income. The province should not consider separate collection of personal income taxes and a single income tax return should be retained.

Rationale:

As noted at the outset, the Committee considered a number of issues regarding Alberta's personal income tax system based on what we heard from Albertans and learned through a number of submissions and studies.

The Committee was particularly concerned with addressing the following issues:

- Improving Alberta's competitive tax advantage.
- Addressing differences between taxes paid by single and double income families.
- Providing tax breaks for low income Albertans.
- Addressing the impact of high marginal income tax rates.
- Indexing tax brackets.
- Simplifying the tax system.

The Committee considered each of these issues and concluded that moving to a new system of tax on income provided the best and most efficient vehicle for addressing them. While most of the issues could be addressed under the current system, the solution or mechanism used would be more complicated, less precise, and would involve adding complexities to the tax system.

For example, the province could set up some type of a tax credit to address differences in the taxation of one and two income families. Similarly, the province could do a rough calculation of the impact of the lack of indexing of tax brackets and tax credits on Albertans, and then make some adjustment to the provincial rate to attempt to account for this impact. The province could also make additional adjustments to the selective tax reduction to reduce the tax burden on low income families. Each of these actions goes against what the vast majority of Albertans we talked with told us — keep it simple!

In the Committee's view, moving to a tax on income approach is the most straightforward, efficient and precise way to address priority concerns with Alberta's tax system.

The Committee also supports a tax on income system for the following reasons.

- **Simplicity** – While it may be somewhat confusing in the short run to introduce a new tax system, the Committee feels that tax on income, combined with recommendation 3, will provide a simpler tax system for Albertans.

- **Flexibility** – As noted earlier, flexibility can be a two edged sword. Some flexibility is beneficial; it allows Alberta to set its own course and respond to changing needs of Albertans. It means we are less bound to decisions made by the federal government on tax policy issues. On the other hand, the Committee does not encourage government to use the flexibility provided in a new tax on income system to tinker with the system or to add unnecessary complexity. Individuals and businesses prefer a tax system that is stable and predictable, and that means continuous changes to the tax system should be avoided.

- **Separation from federal tax changes** – Any time the federal government increases or decreases its tax rates, tax credits, or income brackets, the province's revenues are affected. By moving to tax on income, the province is not as directly tied to decisions made at the federal level.

- **Leadership** – Alberta has often been a leader in Canada when it comes to taking on major reforms. Moving to a tax on income system, combined with the other recommendations made by the Committee, would make Alberta a leader in Canada in tax reform and may set a framework for other provinces to move in a similar direction in the future.

- **Advantages of tax collection agreement retained** – Tax on income permits the provincial government to have the enhanced flexibility and control as discussed above, while at the same time continuing the advantages of the tax collection agreements: federal administration and collection by a single collection agency, one tax return for taxpayers to file, and preservation of a uniform tax base across Canada.

Recommendation 3

The province should introduce a single rate of provincial tax.

Rationale:

The Committee considered various options regarding the number of tax brackets and tax rates and concluded that Alberta should move to a single rate of provincial tax.

This would mean all Albertans pay the same percentage rate of provincial tax on their taxable income. For example, an individual with income of $30,000 would pay 11% on $18,380 (30,000 minus exemption of 11,620), resulting in tax of $2,022, or 6.7% of income. An individual at $60,000 income would pay 11% on 48,380 (60,000 - 11,620), which is $5,322 in tax, or 8.9% of income.

The Committee's conclusion is that a single tax rate, combined with recommendations 5 and 6, provides a progressive tax system and a system that is fair for Albertans at various income levels. The Committee notes these recommendations result in a more equal distribution of after-tax income than that which exists under the current structure.

In moving to a single-rate tax, the Province would eliminate Alberta's temporary deficit elimination taxes — the 0.5% flat rate tax and the 8% surtax — and simplify the system. In the Committee's view, the overall benefits to Albertans are sufficient to warrant making a major change like this in Alberta's tax system.

Recommendation 4

The Committee recommends a single rate of 11%.

Based on our assessment of the impact on Alberta taxpayers, the benefits and costs, the Committee recommends a single tax rate of 11%.

In preparing this recommendation and the following two recommendations on increasing the basic personal exemption, the Committee analyzed the impact on individual Albertans and families at different levels of income. We looked at various options including the possibility of including two or three income brackets. In our view, the benefits of including more than one tax bracket are not sufficient to outweigh the benefits and the simplicity of a single tax rate for provincial taxes.

Charts in this section of our report provide a comparison of how much tax individuals and families would pay under the current system vs. a new tax on income system with a single tax rate.

Examples of proposed tax savings for Albertans

Provincial personal income tax savings for Albertans
(includes impact of refundable Alberta Family Employment Tax Credit)

	Current ($)	Proposed ($)	Tax Savings ($)
One earner family, two children			
$30,000	601	(239)*	840
$55,000	4,394	3,256	1,138
$100,000	10,761	8,206	2,555
Two earner family, two children			
$30,000	260	(203)*	463
$55,000	3,332	3,161	171
$100,000	8,443	7,968	475
Single senior			
$30,000	1,713	1,639	74
$55,000	5,004	4,389	615
$100,000	11,370	9,339	2,031
Single non-senior			
$30,000	1,803	1,839	(36)
$55,000	4,829	4,534	295
$100,000	11,195	9,484	1,711

* Refund

Share of proposed tax cut

	Percentage of Alberta total income	Percentage of Alberta total personal income tax (under the current system)	Percentage of the proposed tax reduction under the proposed personal income tax system
Under $30,000	29%	16%	34%
$30,000 - $100,000	53%	63%	37%
Over $100,000	18%	21%	29%

Source: Alberta Treasury

Recommendation 5

The basic provincial personal exemption should be increased and the spousal exemption should be set at the same rate. Both of these exemptions should be fully indexed to inflation.

Low income working Albertans deserve a tax break.

Rationale:

The intent behind providing a basic personal exemption is to provide a floor below which people pay no income taxes. As noted earlier, the federal government sets the basic personal exemption rate but the province uses the selective tax reduction to increase the level of taxable income people can earn before they have to pay Alberta taxes.

The Committee feels strongly that low income working Albertans, hardest hit by bracket creep, deserve a tax break. Moving to a tax on income system permits the province to take this step. There would no longer be any need for the selective tax reduction mechanism.

The Committee also believes that the current tax differences between single and double income families should be addressed. This recommendation would improve the tax position of single income families.

By indexing the basic and spousal exemptions to the rate of inflation, the province would eliminate its share of the problem of bracket creep. However, bracket creep would continue to be a problem within the federal tax system.

Recommendation 6

An additional 78,000 low income Albertans will come off the provincial tax rolls and pay no Alberta personal income tax.

The basic provincial personal exemption and the spousal deduction should both be set at $11,620. Currently, the basic personal exemption is $6,456 and the spousal exemption is $5,380.

As noted under Recommendation 4, the Committee reviewed a number of combinations and options. The combined impact of an 11% single tax rate and an increase in both the basic personal exemption and the spousal deduction to $11,620 proved to be the best combination for addressing a number of current problems in Alberta's tax system.

By raising the basic personal exemption to $11,620, an additional 78,000 Albertans with low incomes would be taken off the provincial income tax rolls and would be exempt from paying Alberta income taxes. The Statistics Canada measures of low income referred to earlier lend support to this level of basic exemption.

By increasing the spousal exemption to the same amount as the basic personal exemption, and making the other changes recommended, a single income family earning $30,000 would be paying $840 less in income tax.

On average, the impact of recommendations 2 - 6 produce a benefit of $463 for a two income family with two children earning $30,000 and a benefit of $1,138 for a one-earner family with two children earning $55,000.

Recommendation 7

New tax credits should not be added to Alberta's personal income tax system.

Rationale:

The Committee considered suggestions for new tax credits, but the majority of respondents were of the opinion that new tax credits

should not be added. Each new tax credit adds complexity to the tax system and increases overall rates to fund it. The combined impact of the Committee's recommendations addresses the priority problems brought to the Committee's attention through the review process. The Committee's overall view is that a simple, broad based, low rate tax system is the best, most neutral and most economically efficient option for the province. It is much preferable to a complex system with a number of specific tax credits targeted to particular groups of Albertans.

The existing federally-defined non-refundable tax credits (e.g., for medical expenses, students tuition, age, etc.) would continue to be provided provincially (at a minimum at the 1997 level). As well, the Committee assumes that the Alberta Family Employment Tax Credit would be continued.

Recommendation 8

The province should urge the federal government to return to full indexing of basic exemptions and tax brackets.

Rationale:

The Committee understands that many of the tax issues brought to our attention are a function of tax policies of the federal government. The province can only make changes to provincial taxes and is not in a position to fully or directly address the problems identified.

At the same time, the Committee believes that the problems caused by the lack of full indexing are serious. Information presented earlier in this report shows that bracket creep has an impact on people at all income levels, but particularly at the lower income levels.

We strongly urge the provincial government to bring these concerns to the attention of the federal government and to encourage them to take appropriate action.

Recommendation 9

The temporary deficit elimination taxes introduced in the late 1980s should be eliminated.

Rationale:

The Committee consistently heard that the two temporary deficit elimination taxes — the 0.5% flat rate tax and the 8% surtax — should be eliminated. The Committee agrees. The Committee's recommendations for moving to tax on income with a single rate would result in the complete elimination of these taxes. We believe the government should eliminate these temporary deficit reduction taxes.

Recommendation 10

The province should continue to review the future challenges to the tax system and assess their unique impact on Alberta.

Rationale:

Earlier in this report, the Committee highlighted a number of future challenges that may have an impact on Alberta's tax system. This includes the growing impact of electronic commerce and the challenges it poses for the traditional tax system, the impact of changing patterns of work, and global trends in countries' tax mixes to higher proportions of value added taxes (consumption taxes) and lower proportions of personal income taxes.

On the issue of electronic commerce in particular, the Committee understands that work is ongoing not only across Canada but around the world. The Committee encourages the province to be proactive in participating in these various reviews and in assessing the unique impact these trends will have on Alberta's tax system, the province's revenue base and on our competitive position.

What are the benefits?

- Albertans would pay less in provincial personal income taxes and would continue to pay the lowest taxes in Canada.
- An additional 78,000 low income Albertans would be taken off the tax rolls and would pay no provincial income taxes.
- Provincial income tax differences between double and single income families would be reduced.
- Marginal tax rates would be reduced in Alberta. Combined with the federal tax rates, the highest marginal tax rate in Alberta would be 42.3%, down from the current rate of 45.6%. If the federal government also eliminated its surtaxes, the maximum rate in Alberta would be 40%.
- The tax system would be more progressive. Fewer low income Albertans would pay taxes, and every family type in Alberta would benefit — one and two earner families, lone parents, singles and seniors.
- The basic personal exemption would increase by more than inflation for the first time since 1988. And it would more than fully compensate for the lack of indexing since then.
- Taxpayers with an income of $20,000 or less account for about 5% of Alberta income tax, but would receive about 19% of the recommended tax cut. Taxpayers with an income $30,000 or less pay about 16% of Alberta income tax, but would receive about 34% of the recommended tax cut.
- A single rate system would be simpler for Albertans to understand.

What is the impact on provincial government revenues?

We estimate that, if the province implements the Committee's recommendations, provincial income tax revenues would be reduced by about $500 million. Of that $500 million, approximately $350 million is due to the elimination of the temporary deficit elimination taxes — the 0.5% flat rate tax and the 8% surtax.

As well, at a single rate of 11%, the Alberta contribution to non-refundable tax credits, such as education, tuition and medical expenses, will be greater than under the current system. Raising the

basic personal exemption and spousal amounts also contribute to the reduction in revenues.

In terms of administration costs, our understanding is that there would be no ongoing additional administration costs charged by the federal government. There would be some transitional costs involved in setting up the new system. The federal government would continue to collect income taxes on Alberta's behalf so there would be no additional forms to complete.

Reduction in Alberta income tax payable as a result of the Committee's recommendations

Change recommended	Tax reduction ($ millions)
Selective tax reduction, surtax and flat tax elimination	270*
Move to single rate and increase non-refundable tax credits	230
Total	**500**

* Note that the elimination of the selective tax reduction reduces the $350 million tax cut resulting from eliminating the surtax and flat tax.

Source: Alberta Treasury

How can the impact on provincial revenues be accommodated?

Between the 1995/96 – 1997/98 fiscal years the province's revenues from personal income taxes increased by $700 million, and estimates for the current year are that they will grow a further $287 million.

While the Committee was not expected to come up with recommendations that are "revenue neutral" in their impact, we are conscious of the fact that the province cannot, and should not forego revenues that are used to support essential programs and services.

The Committee is of the view that the revenues lost in following its recommendations can be accommodated from additional revenues to the province coming as a result of stronger economic growth and continuous improvements to the province's competitive position. Looking back over the past few years, between the 1995/96 – 1997/98 fiscal years the province's revenues from personal income taxes increased by

$700 million, and estimates for the current year are that they will grow a further $287 million.[11]

In addition, there are potential changes to other tax policies that could be made. Throughout the process of our review, we observed a variety of tax exemptions, royalty rebates, and special programs that have been in place for many years to support various specific sectors of Alberta's economy including oil and gas, transportation, agriculture, and forestry. The Committee suggests that, if the province is looking for ways to make up the revenues lost from implementing changes to the personal income tax system, it should take a careful look at eliminating or reducing a number of these special tax programs over time. In our view, the value of making changes to Alberta's personal income tax system — to business, to individuals, and to the province — outweighs the value of many of these special incentive programs.

Finally, the Committee believes that any changes or reductions in personal income taxes have to be sustainable. We appreciate the volatility of Alberta's revenues. We also understand that the tax system has to generate the basic revenues needed to maintain essential programs and services. Within that context, however, the Committee believes that its recommendations would enhance Alberta's competitive position, address many of the current issues in Alberta's tax system, and most important, provide direct benefits to Albertans.

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[11] Province of Alberta 1996-97 and 1997-98 Annual Reports (June 1997, 1998) and 1998-99 First Quarter Update (August 1998)

Afterword

In its first phase, the Committee considered the issue of tax vehicles to support and encourage knowledge-based industries. We acknowledged the competitive environment across Canada, with a number of provinces moving to specific tax incentives to attract specific industries, primarily research and development and film industries.

In its Phase 1 Report, the Committee recommended against industry specific tax credits, that the province should implement a tax credit for research and development on an interim basis, paralleling the federal program now in place, and that the private and public sectors continue to work at encouraging knowledge-based industry businesses and investment.

As a follow up to those recommendations, the Committee examined a number of other programs and approaches used around the world, and some concepts regarding rewarding success and capital gains taxation. We were unable to find a specific model that has proven to be successful in other jurisdictions, nor were we able to arrive at anything conclusive which clearly outweighed the benefits of a broad-based, low rate tax policy approach. However, we want to reinforce our recommendation from the first phase of our work that ongoing research by both the public and private sectors should continue to seek innovative and creative methods for encouraging knowledge-based industries to locate and prosper in the province. The objective should be to find the best ways to reward success, not just activity, and to ensure that Alberta can develop and maintain a leadership position in knowledge-based industries in the future.

At the conclusion of its work, the Committee wants to thank the Provincial Treasurer, Stockwell Day, for the opportunity to participate in this review and to consider a number of very important tax policy questions. We also would like to thank the many individuals and organizations who made submissions to the Committee. Your opinions and advice have helped guide our work.

As members of the Committee, we believe that our recommendations will lead to a better tax system for Alberta, and provide an opportunity for our province to once again take a leadership role in major tax reform in Canada.

Appendix 1
Summary of Alberta Tax Review Committee Recommendations
Phase 1

In the first phase of its work, the Tax Review Committee concentrated on tax issues related to the knowledge-based industries. From an overall perspective, "The Committee currently believes that the best overall tax policy for Alberta is to provide a low rate, broad based tax environment. If there are exceptions to this overall approach, those exceptions should be clearly justified."

As part of its review, the Committee considered the issues involved and the pros and cons of various options. Specifically, the Committee considered the following issues:

- Targeted tax incentives vs. broad-based low-rate taxes.
- Unlevel playing field for knowledge based industries across Canada.
- Access to patient venture capital.
- The impact of a highly mobile workforce.
- Long-term costs.

The Committee recommended that:

1. **On a transitional basis, the province should implement a 10% tax credit for R&D, paralleling the federal program. The credit should be refundable within the limits set by the federal credit and contain a sunset clause with performance targets.**

   "While in principle, the Committee is reluctant to recommend tax credits for R&D, we have been persuaded by the arguments that suggest these tax incentives are important for Alberta to be able to attract and retain R&D investment in the short run. ... We see this as a transitional measure until such time as the province is able to lower overall taxes."

2. **Government should not introduce industry specific tax credits.**

   "As a basic principle, the Committee does not believe that the province should get into the business of industry-specific tax incentive programs."

3. **The province should not introduce any type of provincial tax incentives for investment in venture capital funds, including Labour Sponsored Venture Capital Corporations.**

   "... LSVCCs are controversial and have had varying degrees of success or failure. Most of these funds have not been able to invest more than half the money they received, and in most cases, they do not address the need or gap for seed and early stage capital in emerging high tech firms. ... In the Committee's view, the refundable nature of the R&D tax credit proposed under recommendation 1 will help address the problem of access to capital since it will provide additional funds for R&D investment."

4. **There should be ongoing research by both the public and private sectors into innovative and creative incentives, including a better delivery system for knowledge-based industries.**

   "While the Committee recognizes the value of knowledge-based industries and the need to ensure that the Alberta Advantage applies fully to these industries, the Committee is not convinced that tax credits are the only, or the most effective, vehicle to achieve this goal. ... In the limited time available for phase 1, the Committee was not able to explore other innovative approaches that could be used. This recommendation, therefore suggests that more work is needed to explore other, more innovative options on an ongoing basis."

Appendix 2
1998 Alberta Tax Review Committee
Phase 2 Submissions

Brent Abbott, Bentley, Alberta

Mike Acheson, Denwood, Alberta

Tim Albers, Brooks, Alberta

Bob Barnetson, Edmonton, Alberta

Pam Barrett, New Democrat Party of Alberta, Edmonton, Alberta

Chris Benesch

Herb Betschart

Ken Boessenkool, C.D. Howe Institute, Toronto, Ontario

Alan J. Bowers, CMA, Red Deer, Alberta

Gordon L. Briggs, Hillspring, Alberta

Vera Brown, Edmonton, Alberta

Rick Bunowicz, Calgary, Alberta

Dwayne Buta, Calgary, Alberta

D. J. Cairns, Red Deer, Alberta

John S. Carpenter, BA, FICB, FCGA, Certified General Accountants of Alberta, Calgary

Bernadette Christie, Grande Prairie, Alberta

Herb W. Clark, Lacombe, Alberta

J. F. Claydon, High Prairie, Alberta

Greg Cole, Drumheller, Alberta

Dirk Cornish, Leduc, Alberta

Mrs. Esther Cunliffe, Edmonton, Alberta

J.S. & Helen J. Dixon, Brant, Alberta

E. Lisbeth Donaldson, Calgary, Alberta

Fred Estlin FCA, Grande Prairie, Alberta

D. S. Evans, Calgary, Alberta

Dr. Arthur Filyk, Athabasca, Alberta

Donna Finucane, Edmonton, Alberta

P. J. Flanagan, Calgary, Alberta

Mike Frey, CA, Grande Prairie, Alberta

Maurice Fritze, Edmonton, Alberta

Krishna (Kris) Gangopadhyay, Wetaskiwin, Alberta

Dr. Mark Genuis, National Foundation for Family Research and Education, Calgary

Bob Giesbrecht, Lethbridge, Alberta

William F Gold, Calgary, Alberta

D. E. Gordon, Fort McMurray, Alberta

Mayor Gordon Graydon, Grande Prairie, Alberta

Tom Griffin, Fort McMurray, Alberta

Robert Henderson

John Henderson CA, Grande Prairie, Alberta

Les Hofer, St. Albert, Alberta

Brian A. Hunter, Edmonton, Alberta

Charles Hyman, Alberta Teachers Association, Edmonton, Alberta

Jerry Iwanus, MA CFP, Camrose, Alberta

R. A. (Bob) Jackson, St. Albert, Alberta

S. Jansen, Sherwood Park, Alberta

Pat Jansen, Edmonton, Alberta

Conrad Jean, St. Paul, Alberta

Michael Jenkinson, Edmonton, Alberta

Alan Johnson

J. Jones, Cochrane, Alberta

Iqbal Kaler, Edmonton, Alberta

Larry Kirkpatrick, St. Albert, Alberta

Roy Klassen, Edmonton, Alberta

Eugene Kozakevich

Walter Kublitz, Calgary, Alberta

Phil Lachambre, Syncrude, Fort McMurray, Alberta

Tracey Lacroix

Dominique Landry, Cardston, Alberta

Ken Laninga

Kelly Lee, Hythe, Alberta

Stephanie Liu, Edmonton, Alberta

Milton B. Mack, Calgary, Alberta

Bonnie Macklin CGA, Grande Prairie, Alberta

N. R. McCabe, Hughenden, Alberta

Fred McHenry, Calgary, Alberta

John McIntosh, Canadian Association of Retired Persons, Calgary, Alberta

Gladys Michaud, Society for the Retired and Semi-Retired, Edmonton, Alberta

Marcella Michiele, Calgary, Alberta

Mark Milke, Canadian Taxpayers Federation, Edmonton, Alberta

Harold L. Morrison, Edmonton, Alberta

Merril E. Muttart, Sylvan Lake, Alberta

Harold Neth, Edmonton, Alberta

E. A. (Joe) Paradis, Edmonton, Alberta

Ian Pennoyer

Cathy Perri, Kids First, Airdrie, Alberta

Irene E. Pfeiffer, Ray Huddlestone, Len Landry, George McKenzie,
Calgary Chamber of Commerce,
Calgary, Alberta

Jerry Pitts, Calgary, Alberta

Mark Radke, Red Deer, Alberta

Henning F. Rasmussen, Westerose, Alberta

Elizabeth Reiner, Edmonton, Alberta

Dr. W. Reynolds MD, Grande Prairie, Alberta

Norbert M. Salamon, Olds, Alberta

Samy F. Salloum Barrister & CA,
Edmonton, Alberta

Howard Sapers, Liberal Party of Alberta,
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Certified Management Accountants of Alberta,
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Cornel Yarmoloy

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